INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	2
Argument	4
Conclusion	9
Appendix	10

CITATIONS

Cases:

Barnhill v. *Commissioner*, 148 F. 2d 913	7
Cohan v. *Commissioner*, 39 F. 2d 540	8
Commissioner v. *Flowers*, 326 U. S. 465	7
Rugel v. *Commissioner*, 127 F. 2d 393	8

Statute:

Internal Revenue Code:

Sec. 23 (26 U.S.C. 1946 ed., Sec. 23)	10
Sec. 24 (26 U.S.C. 1946 ed., Sec. 24)	11
Sec. 25 (26 U.S.C. 1946 ed., Sec. 25)	12

Miscellaneous:

Treasury Regulations 103:

Sec. 19.23(a)-2	12
Sec. 19.23(l)-5	13
Sec. 19.24-1	14
Sec. 19.25-6	15

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 735

EMILY MARX, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 30-41) are not officially reported. The opinion of the Court of Appeals (R. 125-132) is reported at 179 F. 2d 938.

JURISDICTION

The judgment of the Court of Appeals was entered on February 7, 1950. (R. 132.) A motion for leave to file a petition for rehearing was filed

on March 9, 1950 (R. 134), and denied on March 15, 1950 (R. 135). The petition for certiorari was filed on April 7, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the taxpayers were properly apprised of the issues litigated in the lower courts.

2. Whether the Commissioner's determination was arbitrary and void.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved may be found in the Appendix, *infra,* pp. 10-15.

STATEMENT

The issues raised on the petition for certiorari and litigated before the lower courts result primarily from the Commissioner's disallowance of numerous deductions claimed by the taxpayer [1] to represent business expenditures. On her 1940 return, Emily Marx reported total receipts from her law practice of $17,711.62 and claimed business deductions of $7,718.49. The Commissioner disallowed all of the claimed deductions for lack of proper evidence or appropriate information in substantiation thereof. While the Commissioner conceded that the expenditures had been made, he did not concede their deductibility as business expendi-

[1] The taxpayers are attorneys and, though man and wife, are referred to as Victor House and Emily Marx since the latter utilizes her maiden name for professional purposes.

tures. (R. 31.) However, at the hearing the Commissioner conceded that $2,651.76 should be allowed as business expenditures for 1940. (R. 31-32.) Similarly in 1941, when taxpayers filed a joint return, they claimed business deductions in the sum of $9,048.61, and these deductions were also disallowed by the Commissioner for lack of substantiation. Again at the hearing the Commissioner conceded that a portion of the deductions should be allowed. (R. 32-33.) With respect to both taxable years, the Tax Court did not sustain the Commissioner's determinations in full but found that the taxpayers had expended in their business, and could deduct, amounts in excess of those conceded by the Commissioner. (R. 34.)

In addition to disallowing the business expenditures, the Commissioner disallowed for lack of substantiation $200 out of $300 claimed by Emily Marx to represent New York City sales taxes (R. 32); and this determination was sustained by the Tax Court (R. 38). He also refused to permit the deduction of substantial expenditures claimed to have been incurred in 1940 and 1941 in the maintenance of taxpayers' personal winter residence, which was originally purchased with the intention of renting it during the summer months but which was not rented at all in 1940, although rented for the summer months in 1941. The Tax Court sustained the Commissioner's determination in full as to 1940

but allowed a portion of the claimed deductions for 1941. (R. 35.) The Tax Court also sustained the Commissioner's disallowance of losses claimed by Victor House to have resulted from an unfavorable leasing arrangement entered into by House with a family corporation of which he was president. (R. 35.) Finally, the Tax Court sustained the Commissioner's disallowance of dependency credits claimed by Emily Marx for her minor child and her mother-in-law, since it found that both received their principal support from Victor House. (R. 36.) [2]

The Court of Appeals concluded that the record clearly established "a firm basis in the evidence for every finding of fact made by the Tax Court." (R. 132.)

ARGUMENT

The decision of the Court of Appeals affirming the trial court's determination of purely factual issues is patently correct and involves no conflict with any decision. This being so, and since the petition raises no substantial question of law or even of fact, but rather is premised on highly erroneous and novel concepts of well established legal principles and upon a distorted analysis of the facts, the petition should be denied.

At the basis of the petition are two erroneous premises upon which the taxpayers have placed a

[2] Other relatively insignificant factual issues were also litigated before the Tax Court but are not referred to in the petition.

curiously persistent reliance throughout this litigation: the first being that the Commissioner's determination was arbitrary and thus void; and the second that the taxpayers were not informed of the issues and were thus deprived of due process of law. In connection with the first, it is unnecessary to consider the consequences of an arbitrary determination since the Commissioner's determination here was obviously not arbitrary. This case, in its inception, presented to the Commissioner and subsequently to the courts, an elaborate attempt to diminish taxable income improperly by claiming deductions for hundreds of items, most of which involved nondeductible expenditures and the balance of which depended almost wholly on unsubstantiated and highly indefinite testimony of the interested parties.[3] So striking was the improper nature of the

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[3] A few examples of the claimed deductions are as follows: Emily Marx attempted to deduct the entire electric bill for her summer home in Alstead, totalling over $140 for five months, as a business expenditure. At one point she testified that since she did not pay the corporation any rent for her "Alstead office" she "paid out of my office account the electricity of the Lodge where I had my office." (R. 108.) However her husband, Victor House, had already testified that he had rented the lodge as a summer home for his family. Subsequently Emily Marx testified that she deducted the entire electric bill for the lodge because the electric lights were turned on "only when I'm in my office," her office consisting of one second story room in a large dwelling. (R. 118.) Not only did nobody in the home apparently ever turn on the electric lights outside of that one room, but the home telephone at Alstead was "never" used for personal purposes, according to Emily Marx, so that she deducted her entire phone bill. (R. 117.) Emily Marx also attempted

claimed deductions that the Court of Appeals was led to comment (R. 132) that the Tax Court had "acted with restraint, tolerance, and even magnanimity, on a record bearing strong indications of devious and ingenious, though transparent, schemes and devices for evading and defeating taxes." Under such circumstances the Commissioner had no alternative but to disallow the claimed deductions *in toto* for want of proper

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to deduct a Consolidated Edison gas bill of $120.05 representing the gas consumed in her home while she resided there (R. 121), upon what theory the record fails to disclose; but whatever the theory was, it was probably on the same theory that she attempted to deduct over $500 paid to her houseman for services performed at her residence while she occupied it (R. 119). She deducted the cost of her daily newspapers, because she needed "very advanced information" (R. 109), as well as the cost of subscriptions to Time magazine and Reader's Digest (R. 110, 112). She deducted the cost of a Yale dinner because that was "where I get many of my contacts." (R. 110, 112.) She deducted over $800 of food bills to the A & P in 1940 and 1941 because she didn't "belong to any of these luncheon clubs that Mr. House belongs to, and the only place I can entertain my clients is at my home". (R. 109-110, 112.) She attempted to deduct over $400 of "petty cash" with no more explanation than "It might have included stamps, carfares, telephone, small filing fees," and did not even produce the petty cash book. (R. 107.) Not only did the claimed deductions include countless items which were on their face nondeductible, but the testimony offered by Emily Marx was vague and tenuous, often consisting of nothing more than a statement of the conclusion.

As for her husband, he claimed deductions in the amount of $665 for railroad fares which "includes railroad fare from my place of business in Alstead to New York." (R. 82.) As the record demonstrates, Alstead was his summer residence; but since he, like the vast multitude of attorneys, sometimes entertained and met their clients at his home, he considered it appropriate to deduct fares from New York to his summer residence. (R. 81-82.) He deducted $400 of hotel bills while he resided at various New York hotels, despite the fact

records and competent substantiation and to put the taxpayers to their burden. Moreover, despite the fact that the evidence offered by the taxpayers was in many instances far fetched and was extremely vague and tenuous, the Tax Court did not sustain the Commissioner's determination in full, but rather made a generous allowance pursuant to the now well established principle which has been

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that New York was the city where he conducted his law practice and had his law offices; and was of course his home for tax purposes. (R. 83-84.) See *Commissioner* v. *Flowers*, 326 U. S. 465; *Barnhill* v. *Commissioner*, 148 F. 2d 913 (C.A. 4th).

In 1941 when the taxpayers rented their own winter residence for the summer only for $1,075, they claimed as a deduction for depreciation of the buildings $2,500, a sum far in excess of the actual or anticipated rental. (R. 111, 115.) They deducted a whole year's insurance. (R. 26, 111.) They deducted numerous items representing capital expenditures. They deducted $128 for repairing their roof (R. 26) in 1941 on the theory that the damage to the roof was caused by their summer tenants in 1939 (R. 87). When cross-examined as to why he felt entitled to deduct the cost of repairing the roof of his personal residence, and why he waited two years to repair it if it were attributable to the 1939 tenancy, Mr. House replied that, had the house been rented in 1940, they would have "probably then detected it." (R. 88.) Thus apparently the leaky roof was not discovered until 1941. Mr. House testified: "We assumed that somebody [one of the 1939 tenants] had set a chair down heavily and cracked the covering of the roof or something like that * * *." (R. 87.) They deducted $375 for painting their home in 1941, which Mr. House apparently attempted to justify as redecoration necessitated by the 1939 tenants. (R. 87.) When in the cross-examination of Emily Marx it was revealed that the painting bill represented the painting of the outside of the house, the court inquired as to why this was attributable to summer expense. To this Emily Marx replied "Because you would not have to paint the stucco just for yourself, you paint it to draw the $700 a month tenants that you hope you are going to get." (R. 115.) Other items deducted by taxpayers included $1,024.80 for "care of building," and $475 for "cleaning supplies." (R. 26.)

approved by the courts on many occasions in such cases as *Cohan* v. *Commissioner,* 39 F. 2d 540, 544 (C. A. 2d); *Rugel* v. *Commissioner,* 127 F. 2d 393 (C. A. 8th).

The second erroneous premise, namely, that the taxpayers, both of whom are attorneys, were not informed of the issues, is apparently based on the contention that the issue as to the nature and thus the deductibility of the claimed items as business expenditures was not properly before the trial court. It is interesting to note that this proposition, which appeared an unusual one to the appellate court as well as to the Commissioner (R. 130), was advanced for the first time after a trial in the course of which hundreds of pages of testimony were offered by the taxpayers on the very issue now claimed not to have been presented. As a matter of fact, the question of deductibility was the only issue remaining in the trial and had, of course, always been present since the Commissioner in his answers had denied (R. 12, 26) the taxpayers' allegations (R. 3, 13) in their petitions for redetermination that the claimed items represented expenditures made "in the operation of * * * law offices" and "in the practice of her [his] profession."[4]

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[4] Not even passing comment is required in connection with the taxpayers' suggestion (Pet. 8) that the real issue was whether they had substantiated the claimed deductions to the satisfaction of the Internal Revenue Agents, and not whether they had borne their burden of proof before the Tax Court.

CONCLUSION

Since the appellate court's determination is correct and involves no substantial question of law or fact, the petition should be denied.

Respectfully submitted,

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MAY, 1950.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or * * *

* * * * *

(l) [As amended by Sec. 121(c), Revenue Act of 1942, *supra*] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living or family expenses;

* * *

* * * * * *

(26 U. S. C. 1946 ed., Sec. 24.)

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

* * * * * *

(b) *Credits for Both Normal Tax and Surtax.*—There shall be allowed for the purposes of the normal tax and the surtax the following credits against net income:

* * * * * *

(2) *Credit for dependents.*—$400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.

* * * * * *

(26 U. S. C. 1946 ed., Sec. 25.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23(a)-2. *Traveling expenses.*—

* * * * * *

* * * Only such expenses as are reasonable and necessary in the conduct of the business

and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) the number of days away from home during the taxable year on account of business; (3) the total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; and (4) the total amount of other expenses incident to travel and claimed as a deduction.

Claim for the deductions referred to herein must be substantiated, when required by the Commissioner, by evidence showing in detail the amount and nature of the expenses incurred.

Commuters' fares are not considered as business expenses and are not deductible.

SEC. 19.23(l)-5. *Method of computing depreciation allowance.*—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the

return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

* * * * *

SEC. 19.24-1. *Personal and family expenses.* —Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives clients, patients, or callers there in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If,

however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. * * *

SEC. 19.25-6. *Credit for dependents.*—A taxpayer, other than a nonresident alien who is not a resident of Canada or Mexico (see section 214), receives a credit of $400 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under 18, or (b) incapable of self-support because defective.

The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

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